

Internal Revenue Service

Department of the Treasury
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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B02

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Date:

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Legend:

Trust I =

Trust II =

Trust III =

Advisor =

Fund A =

Fund B =

Fund C =

Fund D =

Fund E =

Fund F =

Fund G =

Fund H =

Fund I =

State =

Country =

Dear :

This responds to your request dated January 24, 2007, submitted by your authorized representative on behalf of Fund A, Fund B, Fund C, Fund D, Fund E, Fund F, Fund G, Fund H, and Fund I (each a “Fund,” and collectively, the “Funds”). Funds request that the Internal Revenue Service rule that income arising from investments in shares of foreign corporations that are controlled foreign corporations or passive foreign investment companies constitutes qualifying income for purposes of section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the “Code”).

FACTS

Fund A is a series of Trust I, a State business trust registered as an open-end management investment company under the Investment Company Act of 1940, as amended (the “1940 Act”).

Fund B is a series of Trust II, a State business trust registered as an open-end management investment company under the 1940 Act.

Fund C, Fund D, Fund E, Fund F, Fund G, Fund H, and Fund I are series Funds of Trust III, a State business trust registered as an open-end management investment company under the 1940 Act.

Each Fund qualified as a regulated investment company (RIC) under subchapter M of the Code for its most recent tax year and intends to continue to qualify in all subsequent years. Funds have an investment management agreement with Advisor, except for Fund B which has a sub-advisory agreement with an unaffiliated sub-advisor.

In general, each Fund seeks capital appreciation by investing in securities of companies associated with one sector of the commodities market. Unlike the other Funds, Fund B seeks real return by investing in four general investment categories: inflation-protected debt securities, floating-rate loans, commodity-linked notes and related investments, and real estate investment trusts.

To enhance the performance of its portfolios and to better reflect the pricing of the commodities markets, each of the Funds proposes to form its own wholly-owned subsidiary (Subsidiary) that will be a foreign corporation. Each Subsidiary will be incorporated as an exempted limited company under the laws of Country. Under the laws of Country, an exempted limited company provides for limited liability for all holders of shares. A shareholder's liability is limited to the amount, if any, unpaid with respect to the shares acquired by the shareholder. Each Subsidiary will file an election on Form 8832, Entity Classification Election, to be taxed as a corporation pursuant to section 301.7701-3 of the Procedure and Administration Regulations.

Funds represent that, although the Subsidiaries will not be registered as investment companies under the 1940 Act, each Subsidiary will comply with the requirements of section 18(f) of the 1940 Act, Investment Company Act Release No. 10666, and related SEC guidance pertaining to asset coverage.

Each of the Funds will invest a portion of its assets in its wholly-owned Subsidiary, subject to the limitations set forth in section 851(b)(3). Each Subsidiary will invest primarily in one or more of the following types of instruments: commodity and financial futures and options contracts (and fixed income securities that serve as collateral for these contracts); deliverable forward contracts; and cash-settled nondeliverable forward contracts. Each of these contracts may be linked to the performance of one or multiple commodities (including a commodity index). The Subsidiaries may also invest in swaps on commodities or commodities indexes or in commodity-linked notes. Furthermore, each Subsidiary may also invest directly in commodities.

LAW AND ANALYSIS

Section 851(b)(2) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test (the "qualifying income requirement"). Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources. Section 851(b)(2) defines qualifying income, in relevant part, as—

dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies

Section 851(b) of the Code further provides that, for purposes of section 851(b)(2), there shall be treated as dividends amounts included in gross income under section 951(a)(1)(A)(i) or section 1293(a) for the taxable year to the extent that, under

section 959(a)(1) or section 1293(c) (as the case may be), there is a distribution out of the earnings and profits of the taxable year that are attributable to the amounts so included.

Section 957 of the Code defines a controlled foreign corporation (“CFC”) as any foreign corporation in which more than 50 percent of (1) the total combined voting power of all classes of stock entitled to vote, or (2) the total value of the stock, is owned by United States shareholders on any day during the corporation’s taxable year. A United States shareholder is defined in section 951(b) as a United States person who owns 10 percent or more of the total voting power of a foreign corporation. Initially, each Fund will wholly own each Subsidiary. Each Fund is a United States person. Therefore, each Subsidiary will initially qualify as a CFC under these provisions.

Over time, it is possible that other RICs will invest in one or more of the CFCs. If such other RICs are not United States shareholders because they own less than 10 percent of the voting power of the Subsidiary, the other RICs will take income from the Subsidiary into account under the passive foreign investment company (“PFIC”) rules under section 1291 of the Code. Ultimately, if sufficient additional RICs invest in a given Subsidiary it is possible that the Subsidiary will lose its CFC status, in which case all RICs investing in the Subsidiary will treat the Subsidiary as a PFIC.

Section 952 of the Code defines subpart F income to include foreign base company income determined under section 954. Under section 954(a)(1), foreign base company income includes foreign personal holding company income determined under section 954(c). Section 954(c) defines foreign personal holding company income to include dividends, interest, royalties, rents, and annuities.

Subsidiaries’ investments in futures contracts, option contracts, forward contracts, fixed income securities, commodity swaps and commodity linked notes will produce income that may generate foreign personal holding company income under section 954(c) of the Code, which is subpart F income. Each Fund would therefore include in income the sum of its respective pro rata shares of its Subsidiary’s subpart F income (if the Subsidiary is a CFC with respect to the Fund) for the taxable year in accordance with section 951.

In addition, each Fund will include in income with respect to each Subsidiary that is a PFIC with respect to Fund, its pro rata share of the Subsidiary’s ordinary earnings and net capital gains (“QEF inclusions”) for the taxable year in accordance with section 1293(a) of the Code.

Section 851(b) of the Code includes a specific rule providing dividend treatment for certain subpart F and QEF inclusions (those attributable to distributions out of earnings and profits). Subpart F and QEF inclusions also constitute RIC qualifying income under section 851(b)(2)(A), which states that qualifying income includes “other

income ... derived with respect to [the RIC's] business of investing in ... stock, securities, or currencies" (the "other income rule").

The investment by each Fund in its Subsidiary, that is a corporation for federal income tax purposes, will be an investment in stock. Each Fund's income from its Subsidiary will be derived from its stock ownership and will be "income derived with respect to its business of investing in such stock" under the other income rule of section 851(b)(2)(A).

CONCLUSION

We rule that income derived by each Fund from its investments in its Subsidiary, whether or not attributable to subpart F income or QEF inclusions or without regard to whether the income has been distributed, is income derived with respect to the Fund's business of investing in the stock of Subsidiary and thus constitutes qualifying income to each Fund under section 851(b)(2) of the Code.

No opinion is expressed as to whether each Fund qualifies as a RIC that is taxable under subchapter M, part I of the Code.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Susan Thompson Baker
Susan Thompson Baker
Assistant to the Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Financial Institutions & Products)